plan for the exclusive benefit of employees in general. The law is concerned not only with the form of a plan but also with its effects in operation. For example, section 401(a)(5) specifies certain provisions which of themselves are not discriminatory. However, this does not mean that a plan containing these provisions may not be discriminatory in actual operation.

(4) A plan is for the exclusive benefit of employees or their beneficiaries even though it may cover former employees as well as present employees and employees who are temporarily on leave, as, for example, in the Armed Forces of the United States. A plan covering only former employees may qualify under section 401(a) if it complies with the provisions of section 401(a)(3)(B), with respect to coverage, and section 401(a)(4), with respect to contributions and benefits, as applied to all of the former employees. The term ''beneficiaries'' of an employee within the meaning of section 401 includes the estate of the employee, dependents of the employee, persons who are the natural objects of the employee's bounty, and any persons designated by the employee to share in the benefits of the plan after the death of the employee.

(5)(i) No specific limitations are provided in section 401(a) with respect to investments which may be made by the trustees of a trust qualifying under section 401(a). Generally, the contributions may be used by the trustees to purchase any investments permitted by the trust agreement to the extent allowed by local law. However, such a trust will be subject to tax under section 511 with respect to any ''unrelated business taxable income'' (as defined in section 512) realized by it from its investments.

(ii) Where the trust funds are invested in stock or securities of, or loaned to, the employer or other person described in section 503(b), full disclosure must be made of the reasons for such arrangement and the conditions under which such investments are made in order that a determination may be made whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees. The trustee shall report any of such investments on the return which under section 6033 it is required to file and shall with respect to any such investment furnish the information required by such return. See § 1.6033–1.

(c) *Portions of years.* A qualified status must be maintained throughout the entire taxable year of the trust in order for the trust to obtain any exemption for such year. But see section 401(a)(6) and § 1.401–3.

(d) *Plan of several employers.* A trust forming part of a plan of several employers for their employees will be qualified if all the requirements are otherwise satisfied.

(e) *Determination of exemptions and returns.* (1) An employees' trust may request a determination letter as to its qualification under section 401 and exemption under section 501. For the procedure for obtaining such a determination letter see paragraph (l) of § 601.201 of this chapter (Statement of Procedural Rules).

(2) A trust which qualifies under section 401(a) and which is exempt under section 501(a) must file a return in accordance with section 6033 and the regulations thereunder. See §§ 1.6033–1 and 1.6033–2(a)(3). In case such a trust realizes any unrelated business taxable income, as defined in section 512, such trust is also required to file a return with respect to such income. See paragraph (e) of § 1.6012–2 and paragraph (a)(5) of § 1.6012–3 for requirements with respect to such returns. For information required to be furnished periodically by an employer with respect to the qualification of a plan, see §§ 1.404(a)–2, 1.404(a)–2A, and 1.6033–2(a)(2)(ii)*(i)*.

[T.D. 6500, 25 FR 11670, Nov. 26, 1960, as amended by T.D. 6675, 28 FR 10118, Sept. 17, 1963; T.D. 6722, 29 FR 5071, Apr. 14, 1964; T.D. 7168, 37 FR 5024, Mar. 9, 1972; T.D. 7428, 41 FR 34619, Aug. 16, 1976]

§ 1.401–2 Impossibility of diversion under the trust instrument.

(a) *In general.* (1) Under section 401(a)(2) a trust is not qualified unless under the trust instrument it is impossible (in the taxable year and at any time thereafter before the satisfaction of all liabilities to employees or their beneficiaries covered by the trust) for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of such employees or their beneficiaries. This section does not apply to funds of the trust which are allocated to provide medical benefits described in section 401(h) as defined in paragraph (a) of § 1.401–14. For the rules prohibiting diversion of such funds and the requirement of reversion to the employer after satisfaction of all liabilities under the medical benefits account, see paragraph (c) (4) and (5) of § 1.401–14. For rules permitting reversion to the employer of amounts held in a section 415 suspense acount, see § 1.401(a)–2(b).

(2) As used in section 401(a)(2), the phrase ''if under the trust instrument it is impossible'' means that the trust instrument must definitely and affirmatively make it impossible for the nonexempt diversion or use to occur, whether by operation or natural termination of the trust, by power of revocation or amendment, by the happening of a contingency, by collateral arrangement, or by any other means. Although it is not essential that the employer relinquish all power to modify or terminate the rights of certain employees covered by the trust, it must be impossible for the trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees or their beneficiaries.

(3) As used in section 401(a)(2), the phrase ''purposes other than for the exclusive benefit of his employees or their beneficiaries'' includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust.

(b) *Meaning of ''liabilities''.* (1) The intent and purpose in section 401(a)(2) of the phrase ''prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust'' is to permit the employer to reserve the right to recover at the termination of the trust, and only at such termination, any balance remaining in the trust which is due to erroneous actuarial computations during the previous life of the trust. A balance due to an ''erroneous actuarial computation'' is the surplus arising because actual requirements differ from the expected requirements even though the latter were based upon previous actuarial valuations of liabilities or determinations of costs of providing pension benefits under the plan and were made by a person competent to make such determinations in accordance with reasonable assumptions as to mortality, interest, etc., and correct procedures relating to the method of funding. For example, a trust has accumulated assets of $1,000,000 at the time of liquidation, determined by acceptable actuarial procedures using reasonable assumptions as to interest, mortality, etc., as being necessary to provide the benefits in accordance with the provisions of the plan. Upon such liquidation it is found that $950,000 will satisfy all of the liabilities under the plan. The surplus of $50,000 arises, therefore, because of the difference between the amounts actuarially determined and the amounts actually required to satisfy the liabilities. This $50,000, therefore, is the amount which may be returned to the employer as the result of an erroneous actuarial computation. If, however, the surplus of $50,000 had been accumulated as a result of a change in the benefit provisions or in the eligibility requirements of the plan, the $50,000 could not revert to the employer because such surplus would not be the result of an erroneous actuarial computation.

(2) The term ''liabilities'' as used in section 401(a)(2) includes both fixed and contingent obligations to employees. For example, if 1,000 employees are covered by a trust forming part of a pension plan, 300 of whom have satisfied all the requirements for a monthly pension, while the remaining 700 employees have not yet completed the required period of service, contingent obligations to such 700 employees have nevertheless arisen which constitute ''liabilities'' within the meaning of that term. It must be impossible for the employer (or other non employee) to recover any amounts other than such amounts as remain in the trust because of ''erroneous actuarial computations'' after the satisfaction of all fixed and contingent obligations. Furthermore, the trust instrument must contain a definite affirmative provision to this effect, irrespective of whether

the obligations to employees have their source in the trust instrument itself, in the plan of which the trust forms a part, or in some collateral instrument or arrangement forming a part of such plan, and regardless of whether such obligations are, technically speaking, liabilities of the employer, of the trust, or of some other person forming a part of the plan or connected with it.

[T.D. 6500, 25 FR 11672, Nov. 26, 1960, as amended by T.D. 6722, 29 FR 5072, Apr. 14, 1964; T.D. 7748, 46 FR 1695, Jan. 7, 1981]

§ 1.401–3 Requirements as to coverage.

(a)(1) In order to insure that stock bonus, pension, and profit-sharing plans are utilized for the welfare of employees in general, and to prevent the trust device from being used for the principal benefit of shareholders, officers, persons whose principal duties consist in supervising the work of other employees, or highly paid employees, or as a means of tax avoidance, a trust will not be qualified unless it is part of a plan which satisfies the coverage requirements of section 401(a)(3). However, if the plan covers any individual who is an owner- employee, as defined in section 401(c)(3), the requirements of section 401(a)(3) and this section are not applicable to such plan, but the plan must satisfy the requirements of section 401(d) (see § 1.401–12).

(2) The percentage requirements in section 401(a)(3)(A) refer to a percentage of all the active employees, including employees temporarily on leave, such as those in the Armed Forces of the United States, if such employees are eligible under the plan.

(3) The application of section 401(a)(3)(A) may be illustrated by the following example:

Example. A corporation adopts a plan at a time when it has 1,000 employees. The plan provides that all full-time employees who have been employed for a period of two years and have reached the age of 30 shall be eligible to participate. The plan also requires participating employees to contribute 3 percent of their monthly pay. At the time the plan is made effective 100 of the 1,000 employees had not been employed for a period of two years. Fifty of the employees were seasonal employees whose customary employment did not exceed five months in any calendar year. Twenty-five of the employees were part-time employees whose customary employment did not exceed 20 hours in any one week. One hundred and fifty of the full-time employees who had been employed for two years or more had not yet reached age 30. The requirements of section 401(a)(3)(A) will be met if 540 employees are covered by the plan, as shown by the following computation:

(i) Total employees with respect to whom the percentage requirements are applicable (1,000 minus 175 (100 plus 50 plus 25))	825
(ii) Employees not eligible to participate because of age requirements	150
(iii) Total employees eligible to participate	675
(iv) Percentage of employees in item (i) eligible to participate	81+%
(v) Minimum number of participating employees to qualify the plan (80 percent of 675)	540

If only 70 percent, or 578, of the 825 employees satisfied the age and service requirements, then 462 (80 percent of 578) participating employees would satisfy the percentage requirements.

(b) If a plan fails to qualify under the percentage requirements of section 401(a)(3)(A), it may still qualify under section 401(a)(3)(B) provided always that (as required by section 401(a) (3) and (4)) the plan's eligibility conditions, benefits, and contributions do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or the highly compensated employees.

(c) Since, for the purpose of section 401, a profit-sharing plan is a plan which provides for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as illness, disability, retirement, death, layoff, or severance of employment, employees who receive the amounts allocated to their accounts before the expiration of such a period of time or the occurrence of such a contingency shall not be considered covered by a profit-sharing plan in determining whether the plan meets the coverage requirements of section 401(a)(3) (A) and (B). Thus, in case a plan permits employees to receive immediately the amounts allocated to their accounts, or to have such amounts paid to a profit- sharing plan for them, the employees who receive the shares immediately shall not,